Fiscal Note 2009 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Bill #	HB0842		**Title:**	Tax incentive for inventor & manufacturer of product
Primary Sponsor:	Jacobson, Hal		**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☐ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Expenditures:				
General Fund	$0	$0	$0	$0
Revenue:				
General Fund	Unknown	Unknown	Unknown	Unknown
Net Impact-General Fund Balance	Unknown	Unknown	Unknown	Unknown

Description of fiscal impact: This legislation would give tax exempt status to royalty income from patented products developed or produced in Montana. In addition, this legislation would allow businesses that manufacture a product developed by an inventor in Montana to exclude from taxation an amount equal to 65% of the cost of depreciable property purchased and used to produce the product. The Department of Revenue is unable to estimate the fiscal impact.

FISCAL ANALYSIS

Assumptions:

1. This legislation would exempt from taxation royalty income earned from the use of patented technology, if 1) the royalties were earned by Montana inventors and 2) royalties were paid by a Montana manufacturer for the use of the patented technology in the production of a good. In addition, this legislation would allow Montana manufacturers to exclude from taxation an amount equal to 65% of the cost of depreciable property purchased and used to produce the good, not to exceed $500,000. If the exclusion exceeds Montana adjusted gross income, the excess may be carried forward for a period not to exceed four years. This exemption is in addition to other tax advantages available to the business. In

other words, the manufacturer can continue to claim the research credit and depreciate the depreciable property in addition to claiming the 65% exemption. Under current law, businesses can also deduct royalty payments as a business expense.

2. There is insufficient data to estimate the effect of this legislation. The U.S. Patent and Trademark Office reports that 119 patents were held by Montana businesses and individuals in 2005. There is no way to determine the number of these patents that are currently earning royalties, whether these royalties were paid by Montana manufacturers, or the amount of royalty income earned by these in-state investors. Royalties paid by Montana companies to nonresidents are not considered Montana-source income and are not taxed by Montana.
3. The U.S. Patent and Trademark Office also reports that there are 58 independent inventors in Montana in 2005. It is not known whether all 58 of these investors receive royalty income from these patents, whether the royalties are paid by companies manufacturing the product in Montana, or how much royalty income is received. In other words, a maximum of 58 individuals would benefit from the individual income tax exemption included in this legislation.
4. Assuming that each of the independent inventors only holds one patent, 61 patents are held by Montana businesses. One business may hold multiple patents. Under current law, businesses conducting research and development activities may receive a tax credit for qualified expenses. The number of corporations taking this credit was 17 in tax year 2003 and nine in tax year 2004. There were 12 individuals claiming this credit from their small business on the individual income tax forms. These numbers indicate that the number of taxpayers that would benefit from this legislation would be small. These numbers do not provide sufficient information to develop an estimate of the fiscal impact of the proposed legislation.
5. The Department of Revenue does not anticipate administrative costs related to this exemption.

	FY 2008 Difference	**FY 2009 Difference**	**FY 2010 Difference**	**FY 2011 Difference**
Fiscal Impact:				
FTE	0.00	0.00	0.00	0.00
Expenditures:				
TOTAL Expenditures	$0	$0	$0	$0
Funding of Expenditures:				
General Fund (01)	$0	$0	$0	$0
TOTAL Funding of Exp.	$0	$0	$0	$0
Revenues:				
General Fund (01)	Unknown	Unknown	Unknown	Unknown
TOTAL Revenues	Unknown	Unknown	Unknown	Unknown
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	Unknown	Unknown	Unknown	Unknown

Long-Range Impacts:

1. The intent of this legislation appears to be to encourage inventors to live in Montana and for businesses producing goods that utilize technology patented by a Montana resident to locate in Montana. If this legislation had the desired effect, the cost of the legislation would increase as more investors and

producers moved to Montana. However, most research indicates that technology-related businesses make their location decisions primarily on economic factors other than taxation, such as the quality and education levels of the local workforce, proximity of networks of research-based firms through which information is shared, and access to suppliers and consumer markets. Therefore, the long-term impacts of this legislation are likely to be minimal.

<u>Technical Notes:</u>

1. This legislation has no effective date or applicability date.
2. Under current law, manufacturers can depreciate the cost of business equipment. The proposed law would allow manufacturers to exempt an additional 65% of the cost of the business equipment. The result would be that the overall exemption and deduction over the full depreciation schedule will exceed the cost of the equipment.
3. The term “qualified products” should be defined.
4. The language of the legislation is not clear whether the manufacture must produce the good in Montana or if the manufacture can qualify if they have a presence in the state. This should be clarified.
5. The proposed legislation is not clear in which portions of Title 15 the language should be codified.
6. It is not clear how the provision of subsection 2 will apply to fiscal year filers.
7. The definition of “depreciable property” should be tied to the federal definition for clarity and simplicity.
8. This legislation is not clear whether the exemption amount would be prorated if the equipment was used to manufacture both qualified products and other products.
9. This legislation is not clear whether components manufactured in Montana and used in the production of final products made outside the state would qualify for the exemption.
10. This targeted group of taxpayers already receive the following tax expenditures: increase research and development activities credit; research and development credit; and the new and expanding industry credit.

Sponsor’s Initials	*Date*	*Budget Director’s Initials*	*Date*